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MIDDLE EAST REFORM INITIATIVES: A STAGE-THEORY PERSPECTIVE

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The United States as well as the EU has proposed a number of reform initiatives that would hopefully lead to a more prosperous, democratic Middle East. In general these proposals have been met with little enthusiasm in the region. In part this stems from the fact that the objectives of the reforms often proposed are too vague—a market economy, democracy, and so on. On a technical level, some reforms are no doubt much more effective than others in creating a positive environment of growth and stability. Yet even in most high-level discussions of the various initiatives the likely linkages between reforms and outcomes are never made clear. In fact, this quantitative dimension is almost totally disregarded in the on-going debates, no doubt contributing even further to the wide-spread ambivalence, suspicion, and skepticism concerning reforms that is pervasive throughout the region.

INTRODUCTION

Leading up to the war and especially after the swift military defeat of Saddam Hussein's regime, optimism was running high among many Iraqis and American planners that the country would be quickly transformed into a free, democratic nation with a liberalized market economy. Yet even after the June 28, 2004 transfer of sovereignty to an interim Iraqi government, the obstacles to these goals loom larger than ever.¹ The insurrection is taking a huge toll of US troops, Iraqi citizens, foreign aid workers and diplomats. The insurgent's aim is to sabotage economic reconstruction and the building of democratic institutions that could make Iraq a showcase for neighboring Arab countries that have drifted listlessly in repressive backwardness.²

US hopes to bring economic gains and democracy to the Middle East and North Africa region as a whole have also been thwarted. The original idea of revitalizing the region arose in response to September 11 and the growth of Islamic extremism. At that time US authorities began to realize that the lack of democracy and freedom, economic stagnation and wide-spread unemployment were driving many young people in the Middle East and North Africa towards extremism and terrorism. The existence of pro-American, yet autocratic regimes was no longer a guarantee for lasting stability. But since the time a first draft of the reform plan for economic and political liberalization, dubbed the Greater Middle East Initiative (GMEI),³ was leaked in February 2004, Arab reaction has been less than enthusiastic.

Many Middle Eastern countries are skeptical of the US approach to reforms and motives for change in the region, so implementation is highly problematic. But even with broad acceptance of the need for reforms, a number of daunting obstacles remain.

Many of the generalities found in discussions concerning the wisdom and viability of US-backed Middle East reforms are of little value in assessing the outcome of these efforts. Clearly many Middle Eastern countries are highly skeptical of the US approach to reforms and motives for change in the region, so implementation is highly problematic. But even with broad acceptance throughout the region of the need

for reforms, a number of daunting obstacles remain. The current state of affairs is best summed up by Anthony Cordesman:

Broad, vacuous US calls for region wide change are the last thing needed in a climate of such deep regional distrust; they only aid the cause of terrorism. Washington instead should work steadily with its G8 partners, friendly Arab governments and local Arab reformers to create reform initiatives tailored to a given country's needs that inspire confidence that the US wants reform for the country's sake rather than for its own political ends. It should also be recognized that the US cannot succeed without fully funded nation-by-nation efforts tailored to the economic, social and political needs of given countries.⁴

More fundamentally, the objectives of the reforms often proposed are too vague—a market economy, democracy, and so on. On a technical level, some reforms are no doubt much more effective than others in creating a positive environment of growth and stability. Yet even in most high-level discussions of the US initiative, the likely linkages between reforms and outcomes are never made clear. In fact, this quantitative dimension is almost totally disregarded in the on-going debates, no doubt contributing even further to the wide-spread ambivalence, suspicion, and skepticism concerning reforms that is pervasive throughout the region.

The sections below attempt to address the quantitative dimension of reforms through developing a framework for identifying country needs and sequencing strategies. Which countries are in the greatest need of reforms? Which reform mix appears most effective given the existing state of affairs in each country? How can reforms be efficiently sequenced to fit in to a long-term strategy of increased stability and prosperity?

BACKGROUND

The Initiative was inspired by the 1975 Helsinki accords, signed by 35 nations (US, the former Soviet Union, and most European states). That pact was designed to recognize disputed post-World War II borders and establish a mechanism for settling other disagreements. Human rights and fundamental freedoms became key parts of the treaty, and the West promoted and protected dissident groups in the Soviet bloc and urged greater freedoms for its residents.

In a similar fashion, the Initiative consists of a statement of principles about “human dignity, freedom, democracy, rule of law, economic opportunity, and social justice” and the establishment of Forum for the Future, a framework for regular ministerial level meetings on political and economic reform in the Broader Middle East and for parallel meetings of civil society and business leaders.

In short, the plan is based on the assertion that stopping the growth in “the region’s pool of politically and economically disenfranchised individuals,” will slow the trend towards rising “extremism, terrorism, international crime and illegal migration” in the region. The Initiative addresses topics such as open markets, free elections, press liberty and support for human

rights organizations. In terms of scope, the Initiative covers the twenty-two nations of the Arab League, Turkey, Israel, Pakistan and Afghanistan.

According to the official statement released by the G-8, at its June 2004 meetings, the Initiative (or Partnership) will focus on three areas:

Political. In the political sphere, progress toward democracy and the rule of law entails instituting effective guarantees in the areas of human rights and fundamental freedoms, which notably imply respect for diversity and pluralism. This will result in cooperation, the free exchange of ideas, and the peaceful resolution of differences. State reform, good governance and modernization are also necessary ingredients for building democracy.

Social/Cultural. In the social and cultural sphere, education for all, freedom of expression, equality between men and women as well as access to global information technology are crucial to modernization and prosperity. A better educated workforce is a key to achieve participation in the globalized world. We will focus our efforts to reduce illiteracy and increase access to education, especially for girls and women.

Economic. In the economic sphere, creating jobs is the number one priority of many countries in the region. To expand opportunity, and promote conditions in which the private sector can create jobs, we will work with governments and business leaders to promote entrepreneurship, expand trade and investment, increase access to capital, support financial reforms, security property rights, promote transparency and fight corruption. Promotion of intra-regional trade will be a priority for economic development of the Broader Middle East and North Africa.

The plan to support reform is focused on the need to deepen democracy and broaden public participation, build a knowledge society and promote economic development. In part these objectives are to be met through a series of initiatives. These include a microfinance initiative to help small entrepreneurs, a project to enhance literacy, and support for training programs for business and entrepreneurship.

In the aftermath of the G-8 meetings, it was not clear how these activities will be financed. The vagueness of the statements adopted, the generalities concerning the objectives, the possible absence of financial support, European ambivalence and Arab government concern over outside interference in their internal matters, have led many to suggest that the Initiative will

not turn out to be the catalyst for reform envisaged by the United States.⁵ While it is too soon to tell what role the Initiative will have in assisting modernization in the region, few would deny that reforms must be undertaken in one form or another if the region is to have any hope of providing an improved standard of living for its rapidly expanding population.

AREAS OF REFORM

The reforms often suggested for the Middle East by US officials fall into two broad categories: (a) those intended to develop efficient market-based economies, with increased economic freedom, and (b) those related to democracy and improved governance.

Economic Freedom

Both the Heritage Foundation/*Wall Street Journal's* Index of Economic Freedom⁶ and the Fraser Institute's Economic Freedom of the World⁷ provide good measures of the relative progress made by countries in moving to a deregulated, limited government, free-market environment. Because the Heritage Foundation data set included more of the Middle Eastern countries it was used for the analysis that follows. The Heritage Index reflects the absence of government constraint or coercion on the production, distribution or consumption of goods and services. Stripped to its essentials, economic freedom is concerned with property rights and choice. To measure economic freedom the Heritage Foundation/*Wall Street Journal* Index takes ten different factors into account:

1. Trade policy;
2. Fiscal burden of government;
3. Government intervention in the economy;
4. Monetary policy;
5. Banking and finance;
6. Capital flows and foreign investment;
7. Wages and prices;
8. Property rights;

9. Regulation; and
10. Informal market.

Implied in these measures is the notion that economic freedom also requires governments to refrain from many activities. They must refrain from actions that interfere with personal choice, voluntary exchange, and the freedom to enter and compete in labor and product markets. Economic freedom is reduced when taxes, government expenditures, and regulations are substituted for personal choice, voluntary exchange and market coordination. Restrictions that limit entry into occupations and business activities also retard economic freedom.

The index provides a framework for understanding most of the objectives of US reform efforts in the region: how open countries are to competition, the degree of state intervention in the economy, whether through taxation, spending or overregulation, and the strength and independence of a country's judiciary to enforce rules and protect private property. Some countries may have freedom in all factors; others may have freedom in just a few. One of the most important findings of research carried out using the index is that economic freedom is required in all aspects of economic life. That is, countries must score well in all ten of the factors in order to improve their economic efficiency and consequently the living standards of their people.⁸

Governance

The other main area of US reform efforts, democracy and governance are increasingly seen as essential for long run economic growth and prosperity. In fact some dimensions of governance now sit at the center of academic and policy discussions of economic development.⁹

While the ranking of countries on the basis of their relative progress in attaining improved governance is inherently subjective, a recent World Bank study¹⁰ provides a set of rankings incorporating the full extent of our knowledge about this phenomenon. More precisely, the World Bank data set presents a set of estimates of six dimensions of governance covering 199 countries and territories for 1996, 1998, 2000 and 2002.

Voice and Accountability. This variable measures various aspects of the political process, civil liberties and political rights. These indicators measure the extent to which the citizens of a country are able to participate in the selection of governments. Also included in this variable are indicators measuring the independence of the media.

Political Stability and Absence of Violence. This governance cluster combines several indicators which measure perceptions of the likelihood that the government in power will be destabilized or overthrown..

Government Effectiveness. This variable combines aspects of the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies.

Regulatory Quality. This aspect of governance is more focused on the policies themselves. It includes measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.

Rule of Law. Included in this dimension of governance are several indicators which measure the extent to which the citizens of a country have confidence in and abide by the rules of society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.

Control of Corruption. This dimension of governance measures perceptions of corruption. By this measure, corruption is defined as the exercise of public power for private gain. It is often a manifestation of a lack of respect of both the corrupter and the corrupted for the rules which govern their interactions, and hence represents a failure of governance.

As a whole, the Broader East Initiative countries have lagged considerably behind other major groupings of countries (Table 1). The high growth (so called "catching up") developing countries¹¹—Malaysia, Thailand, Mexico etc.—have made considerably more progress in nearly all of the major areas of reform. In turn there is a comparable but generally smaller gap between the various reform measures of the catching-up and advanced countries.

The reform gap between the Broader Middle East Initiative (BMEI) countries and those catching up to the advanced economies is particularly

evident in the main dimensions of governance (lower values in Table 1 represent a worsening of governance). While the gaps between the BMEI countries and the catching-up countries are not as great in the economic freedom area, they are still fairly consistent (higher values in Table 1 for these variables signifies a worsening of economic freedom) across all ten dimensions with the exception of monetary policy.

Finally, the standard deviations of nearly all reform dimensions are relatively high across the board for the Broader Middle East Initiative countries. This suggests considerably more diversity of reform experiences within this group of countries relative to those found in the catching-up and advanced economies.

Table: 1

Greater Middle East Initiative Countries Governance-Economic Freedom Group Comparisons						
	Voice	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Broader Middle East Initiative Countries (20 Countries)						
Mean	-0.91802	-0.37126	-0.17018	-0.41027	-0.01853	-0.17146
Std. Deviation	0.470583	0.989188	0.720173	1.096394	0.859818	0.673571
Catching-Up Economies (37 Countries)						
Mean	0.48504	0.35871	0.28211	0.46249	0.26696	0.15342
Std. Deviation	0.581143	0.622755	0.511180	0.415176	0.521825	0.544002
Advanced Economies (25 Countries)						
Mean	1.27878	1.15325	1.70471	1.34893	1.74568	1.84731
Std. Deviation	0.396079	0.446343	0.373612	0.288472	0.331339	0.443233
	Trade Policy	Fiscal Burden	Government Intervention	Monetary Policy	Foreign Investment	
Broader Middle East Initiative Countries (20 Countries)						
Mean	3.87135	3.55462	3.47632	2.46959	3.22105	
Std. Deviation	1.131846	0.886989	0.765516	1.435857	0.987222	
Catching-Up Economies (37 Countries)						
Mean	3.16592	3.39094	2.49234	3.10698	2.51254	
Std. Deviation	0.953574	0.648153	0.598365	0.955559	0.498750	

Greater Middle East Initiative Countries Governance-Economic Freedom Group Comparisons						
Advanced Economies (25 Countries)						
Mean	1.94089	4.01658	2.45400	1.27189	1.90178	
Std. Deviation	0.289542	0.797321	0.588025	0.364115	0.531872	
	Banking& Finance	Wages& Prices	Property Rights	Regulation	Informal Market	
Broader Middle East Initiative Countries (20 Countries)						
Mean	3.35380	3.12339	3.06491	3.27302	3.37690	
Std. Deviation	1.053723	0.830339	1.186112	0.834108	1.367260	
Catching-Up Economies (37 Countries)						
Mean	2.76156	2.59512	2.66494	3.12830	3.27387	
Std. Deviation	0.585669	0.570191	0.805735	0.714370	0.783671	
Advanced Economies (25 Countries)						
Mean	2.00000	2.07278	1.24044	2.42633	1.37444	
Std. Deviation	0.745632	0.329991	0.409115	0.609504	0.585709	
Notes: Governance data, Average Values 1996-2002, Economic Freedom data, Average Values 1995-2004. Source: Compiled from: Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, Governance Matters III: Governance Indicators for 1996-2002, (Washington: World Bank, June 30, 2003), and Index of Economic Freedom Rankings, (Washington: Heritage Foundation), various issues.						

A CONCEPTUAL FRAMEWORK

The various dimensions of economic freedom and governance provide a good gauge of the progress made by the BMEI countries in reforming their economies and political systems. However, to fully appreciate the contribution made by these reforms, one needs to see them in a broader context. Which combinations and levels of reforms appear to be associated with higher levels of development and modernization? Which reform strategies appear most efficient in placing a country on the path to sustainable levels of prosperity? What is a reasonable period of time to assess a country's progress in creating an environment capable of supporting a process of on-going growth and development?

Since both the catching-up and advanced economy groupings are defined largely on their member country's over-all economic performance,

sub-groupings of the BMEI countries also based on an economic performance/modernization criteria should provide a more insightful framework for assessing each country's reform progress to date as well as the tasks that lie ahead.

As with the catching-up and advanced groups of countries, one approach is to examine sup-groups of BMEI countries based on their relative development or stage of economic progress. A stage approach is hardly new. For several centuries historians and philosophers have been attracted by the possibility of expressing the historical process as a sequence of stages instead of a simple chronological succession. Examples of such attempts include Marx's well known pattern by which feudalism gave way to bourgeois capitalism followed by socialism and then communism. This stage approach was especially influential in German historiography. Karl Bucher discussed the evolution of the "household economy" of antiquity into the "town economy" of the late Middle Ages, and thereafter into the "national economy" of modern times.

The common aim of stage theories is to design a model of the historical process by specifying and isolating a limited number of factors which characterize and identify the different stages. Such models are illuminating and justifiable if they identify genuine key variables and reveal otherwise unexpected relationships. Their suitability for prediction is especially significant. Most models implicitly or explicitly claim to explain or predict through postulated changes in the key variables. These changes are in turn derived either from *a priori* reasoning, or on the basis of empirical data. Without the specified changes, development from one stage to another will not occur, or will occur only exceptionally. If a model can successfully identify the key variables and significant changes in them propelling a country to a higher level of development and modernization, then a power tool of explanation and prediction will have been created. In this regard, several modern stage theories hold out the potential for providing a useful framework for assessing the role of reforms in advancing the BMEI countries.

The Rostow Framework

Of the modern stage theories, that developed¹² by W.W. Rostow is by far the most widely discussed. Rostow, an economic historian, was interested

in explaining why some countries became advanced developed economies, while others remained mired in poverty. His framework draws on observations taken from the histories of developed countries which he contended reveal a considerable degree of uniformity with regard to patterns and processes of development.

Based on these observations he divided the modernization process into five stages: (1) the traditional society, (2) the preconditions for take-off, (3) the take-off stage, (4) the drive to maturity and (5) the age of high mass consumption. His basic classic argument was that (1) all societies sooner or later will pass through the same sequence of five economic stages, (2) the world's poor societies are simply those that have not passed beyond the first two states, and (3) development is a process whereby traditional values are replaced by a spirit of individualism and a scientific attitude that encourages economic growth and technological progress.

For each stage, Rostow specified a number of distinguishing characteristics. The preconditions stage was characterized by him as a period of dramatic increases in agricultural productivity, political stability, heavy migration to the cities, substantial development of transportation and other forms of social overhead capital, and increasing capital goods imports financed by capital inflows and well as by raw material exports.

The take-off state is characterized by a jump in the rate of productive investment from 5 percent or less to 10 percent or more of national income, the development of one or more substantial manufacturing sectors with a high growth rate, the existence or quick emergence of a political, social and institutional framework "which exploits the impulses to expansion in the modern sector and the potential external economy effects of the take-off and gives to growth an on-going character."¹³ Furthermore, the time required for the take-off period should be relatively short, no longer than 20 to 30 years. Finally the post-take-off stage is characterized by a shift of leading sectors, an eventual smoothing out of the growth rates, and less

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and less structural change.

While appearing straightforward, Rostow's approach to modernization/development has come under relentless attack.¹⁴ Academic careers have been made by simply finding holes and inconsistencies in his approach. One line of criticism contends that Rostow's theory failed to recognize that developing countries are surrounded by a quite different international economic system than the system that surrounded the advanced countries at the time when they began to develop. As proponents of dependency theory indicated, the economic positions of the developed and underdeveloped countries of the world are linked historically and cannot be understood in isolation from one another.

Other valid criticisms surround Rostow's use of stages. A closer look at his framework suggests that many of the stages are not defined by a set of unique variables—high rates of savings and investment were probably necessary to complete the pre-conditions stage, especially where extensive infrastructure was required.

On a more fundamental level, it is clear that the building of a classificatory system does not, by itself, constitute a stage theory. As noted above, the theory must also explain how and why any particular country moves from one stage to another. In that respect, Rostow's efforts appear incomplete and unsuccessful. For example, in explaining the transition to take-off, Rostow suggests that industrialization and take off may be induced by a favorable shift in the terms of trade resulting from the rise in agricultural productivity in the preconditions stage. However, capital imports, urbanization, education, entrepreneurship, the opening up of foreign markets, and numerous other factors provide alternative explanations.

Finally, implicit in the Rostow model is the notion that countries advance from one stage to another, yet there are numerous examples noted below of countries that appeared to take off, but later fell back rather than advancing to the drive-to-maturity stage. In retrospect, Rostow greatly underestimated the force of negative factors created during the growth process—factors that often became strong enough to retard or even stop the growth/modernization process.

In sum, when using Rostow's approach one has great difficulty formulating a demarcation rule for deciding whether at a finite point in time a specific country can be classified in one stage or another. Nor is it clear

the precise manner in which a country advances to the next stage. Because the mechanisms of stage placement and advancement are vague in Rostow, the model has proved to be of very limited value in policy discussions. In effect, it is a tautology—countries take-off when they satisfy the conditions for take-off.

The New Second World Framework

No doubt benefiting from the insights provided by Rostow's critics, Jennifer Bremer and John D. Kasarda have recently constructed¹⁵ a stage theory taking into account many of the growth depressing elements Rostow overlooked forty years earlier. They term their main conceptual construct "The New Second World." This is a group of countries that have reached middle-income status over the past two decades and that are now in the midst of the critical economic and political transitions from third world to the first.

The New Second World transition has three phases. The first, or early phase, typically begins when a low-income country starts to industrialize rapidly, launching an agrarian-industrial transition and the complex transformations—urbanization, income growth, economic diversification—that accompany it. In a process similar but not identical to Rostow's the take-off occurs if growth continues for a decade or more. In that case, the country reaches the middle New Second World phase.

In the second phase, industrial production per capita may now be around three times what it was when the transition started, and growth in low-value-added manufacturing is rapid and sustained. Incomes rise and a middle class begins to emerge. Bremer and Kasarda note that if this middle phase continues for 10 to 20 years, the country would likely reach the advanced phase, often a time of recurring economic crisis and political turmoil. Countries currently in this advanced group include Argentina, Brazil, and Poland.

Since many of the key Middle Eastern countries are in the first stage or "failed take-off stage"—Iran, Iraq, Syria, Saudi Arabia and Pakistan (included in the United States' Greater Middle East Initiative¹⁶), our attention is focused mainly on the problems encountered by that group. These countries have failed to move forward to the middle stage largely

because of growth-limiting policies and institutional rigidities. As Bremer and Kasarda note: "History suggests that failure to make steady progress through the New Second World transition's early phase to the middle period is extremely dangerous. If the transition stalls here—as it did in post-World War I Russia, and as it has now in much of the Middle East—failure can lead to revolution and Al Qaeda-style international violence." In fact, terrorism and environments that breed

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it are central to Bremer and Kasarda's model. Terrorism is one of the negative side-effects neglected by Rostow and no doubt responsible for that model's poor predictive capabilities.

The one thing that the nations stuck in the early phase have in common is slowness in adopting choice-based systems. Bremer and Kasarda define "choice-based" systems as encompassing both market-based economies and democratic political institutions and organizations.

In sum, the Second World country groupings identified by Bremer and Kasarda, should be able to be defined (profiled) largely in terms of

their attainment of the various economic freedom and governance reforms listed above. If this is the case, their framework lends itself to the country placement in stages and the requirements for their succession to higher stages that eluded Rostow.

STAGES OF REFORM IN THE BMEI COUNTRIES

Based on Bremer and Kasarda's characterization of Second World Development, a sample of countries were selected, with each country broadly meeting the profile of one of their unique stages. Sixteen countries were initially deemed first stage or failed take-off countries, six countries were placed in their second stages and twenty-five were classified as stage three

countries. A fourth group of countries, normally considered “Advanced Developed Countries” was also included in the analysis.

A statistical technique, discriminant analysis¹⁷ was then performed¹⁸ to determine if the countries were “correctly” grouped. That is, is it possible that the six governance and ten economic freedom variables define four sets (corresponding to the three New Second World and one advanced developed) of unique reform environments? If this is the case, countries possessing a particular set of reform attainments would be classified with a high degree of probability in one of these groups. In this case the discriminate procedure would generate a numerical function, indicating, for each country, the reforms necessary and the extent to which they would have to be improved if it wanted to advance to the next stage.

Summarizing¹⁹ the main results, the analysis found that the relative country attainment in only five reform areas (in declining order of importance): government effectiveness, voice, regulation, regulatory quality, informal markets and fiscal burden (Table 2) were sufficient to correctly place all of the sample countries in their anticipated stages of development (Table 2).²⁰

Table: 2

New Second World/Advanced Country Governance-Economic Freedom Group Comparisons						
	Voice	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
First Stage—Failed Take-Off Companies						
Mean	-0.87747	-0.72836	-0.77738	-0.90270	-0.72285	-0.77003
Second Stage Countries						
Mean	-0.54797	-0.46558	-0.07078	0.05316	-0.15717	-0.33948
Third Stage Countries						
Mean	0.67524	0.65898	0.68582	0.77153	0.70353	0.59154
Advanced Countries						
Mean	1.40100	1.23800	1.71920	1.32688	1.77151	1.86632

New Second World/Advanced Country Governance-Economic Freedom Group Comparisons						
	Trade Policy	Fiscal Burden	Government Intervention	Monetary Policy	Foreign Investment	
First Stage—Failed Take-Off Companies						
Mean	4.07391	3.54233	3.49628	3.76974	3.54792	
Second Stage Countries						
Mean	3.71667	3.54167	2.75000	3.33333	2.83333	
Third Stage Countries						
Mean	2.68378	3.30339	2.40689	2.73433	2.23411	
Advanced Countries						
Mean	2.02374	4.17066	2.43864	1.18169	2.01566	
	Banking & Finance	Wages & Prices	Property Rights	Regulation	Informal Market	
First Stage—Failed Take-Off Companies						
Mean	3.76379	3.46766	3.77639	3.88740	4.34444	
Second Stage Countries						
Mean	3.33333	3.00000	3.11667	3.81667	3.92500	
Third Stage Countries						
Mean	2.52800	2.41944	2.11833	2.55720	1.30505	
Advanced Countries						
Mean	1.99545	2.08725	1.22778	2.55720	1.30505	
Notes: Governance data, Average Values 1996-2002, Economic Freedom data, Average Values 1995-2004. Source: Compiled from: Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, Governance Matters III: Governance Indicators for 1996-2002, (Washington: World Bank, June 30, 2003), and Index of Economic Freedom Rankings, (Washington: Heritage Foundation), various issues. Variables significant in the discriminant analysis in order of importance: Government Effectiveness, Voice, Regulation, Regulatory Quality, Informal Markets, Fiscal Burden. Correct Placement: Failed Take-Off 100.0%, Second Stage Countries, 100.0% Third Stage Countries, 100.0% Advanced Countries, 100.0%. Overall, 100.0%.						

As in any good stage theory of development there is a gradual improvement in most indices as one moves from lower to higher stages.¹ This pattern is particularly evident in the governance area. The first stage countries score particularly low in this general area of reform. Iraq, Libya, Nigeria and Tajikistan most closely fit the profile of first stage countries. On the

other hand, Pakistan, Armenia, Bosnia, and Albania, show some of the characteristics often associated with the second stage group.

In the context of Bremer and Kasarda's theory, the first stage countries are unable to sustain their take-offs due to diminishing returns caused by poor regulation, corruption, ineffective government and the lack of democracy. The high rates of investment and industrialization noted by Rostow were not sufficient to overcome the barriers imposed by these institutional shortcomings.

As noted, a large number of Broader Middle Eastern countries were profiled in this group: Iran, Iraq, Libya, Pakistan, Saudi Arabia, and Syria (Table 3). While improvements in the sixteen areas of reform eventually occur as countries move to higher stages, progress in government effectiveness and political stability appear particularly critical for the advancement of the first stage countries to the second stage. Based on the large gap in discriminant values between the first and second groups, with the exception of Pakistan, most of these countries have a long way to go before reaching second stage status. A realistic time frame for this transition, assuming persistent efforts at reform, is at least ten years.

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As Bremer and Kasarda suggest stage two is likely to be a fairly long and peaceful period of growth and consolidation. Egypt and Turkey are well-profiled to be in this group, with India best positioned to advance to the next stage. To advance to the third stage however, several areas of reform appear critical. While significant strides have to be made in a number of reform categories, voice, regulation and foreign investment are the areas in need of special attention.

Taiwan appears to be the country currently best placed to reach advanced country status. Of the sample Middle East countries only the UAE falls in this group. A wide variety of reforms appear essential for advancement including: fiscal burden, informal markets, voice, monetary policy, and property rights.

Table: 3**New Second World Countries: Probability of Group Placement**

Country	Failed Take-off	Second Stage Countries	Third Stage Countries	Advanced Countries
First Stage—Failed Take-Off Companies				
Albania	0.81522	0.18458	0.00020	0.00000
Armenia	0.69037	0.30953	0.00009	0.00000
Azerbaijan	0.89012	0.10988	0.00000	0.00000
Bosnia	0.71194	0.28806	0.00000	0.00000
Iran	0.94391	0.05609	0.00000	0.00000
Iraq	1.00000	0.00000	0.00000	0.00000
Kenya	0.63930	0.36070	0.00001	0.00000
Libya	0.99809	0.00191	0.00000	0.00000
Moldova	0.97864	0.01240	0.00896	0.00000
Nigeria	0.98742	0.01258	0.00000	0.00000
Pakistan	0.55815	0.44185	0.00000	0.00000
Russia	0.98121	0.01784	0.00095	0.00000
Saudi Arabia	0.90513	0.09411	0.00076	0.00000
Syria	0.88671	0.11329	0.00000	0.00000
Tajikistan	0.99980	0.00020	0.00000	0.00000
Venezuela	0.98188	0.01802	0.00010	0.00000
Second Stage Countries				
China	0.00712	0.99288	0.00000	0.00000
Egypt	0.00939	0.99061	0.00000	0.00000
India	0.28433	0.69351	0.02215	0.00000
Indonesia	0.04384	0.95616	0.00000	0.00000
Mexico	0.00562	0.99381	0.00057	0.00000
Turkey	0.02715	0.97284	0.00001	0.00000
Selected Third Stage Countries				
Argentina	0.00001	0.00000	0.99999	0.00000
Brazil	0.07550	0.02556	0.89893	0.00000
Chile	0.00000	0.00000	0.99954	0.00046
Czech Republic	0.00000	0.00000	0.99994	0.00006
Greece	0.00000	0.00001	0.99909	0.00091
Hong Kong	0.00000	0.00000	1.00000	0.00000
Hungary	0.00000	0.00000	0.99269	0.00731
Israel	0.00000	0.00001	0.99871	0.00129
Latvia	0.00035	0.00088	0.99877	0.00000
Lithuania	0.00004	0.00004	0.99992	0.00000
Malaysia	0.00035	0.00075	0.99889	0.00001
Poland	0.00000	0.00000	0.99772	0.00228
Singapore	0.00000	0.00000	0.98683	0.01317
Slovak Republic	0.00001	0.00001	0.99995	0.00004
Slovenia	0.00000	0.00000	0.99831	0.00169
South Africa	0.00000	0.00000	0.99994	0.00006
UAE	0.00283	0.00055	0.99661	0.00000

In sum, the findings presented above are quite encouraging. Usually significant progress in only several key reform areas at a time is necessary to produce significant results. In this regard great flexibility exists. In the case of movement from the first to second stage, progress is critical in government effectiveness and political stability. However, equal efforts are not required in both areas. Depending on internal political constraints, some countries might want to opt for relatively more effort in the effectiveness area, while others might feel more comfortable in the political stability area—both strategies have the potential to be successful in elevating a particular country to the next stage.

CONSTRAINTS ON BMEI REFORMS

While an honest effort at reform appears to pay extremely high dividends in terms of economic progress and stability, initiating serious action in this area in the BMEI countries will be another matter. As noted above, few in the Middle East appear neutral when it comes to U.S. reform initiatives. While many appear to feel economic and political reforms are necessary and overdue, many are highly skeptical over those proposed by the US. Doubters fall into three distinct groups:²²

The findings presented above are quite encouraging. Usually significant progress in only several key reform areas at a time is necessary to produce significant results.

Cautious optimists: This group sees the US reform initiatives as a positive project in principle with the potential to help the region modernize itself politically and economically, but only if certain preconditions are met—these involve acceptability of the core concepts to the regional actors. Just as importantly, participation would be wise only under the understanding that each country has its own special needs and aspirations and these must be respected. In Iraq this group is represented by many of the returning expatriates as well as a fairly large number of technocrats from the former regime.

Pessimists: This view dismisses the project as unwise and undoable. A foreign-made project designed to transform Muslim countries through

foreign social engineering will trigger deep regional resistance. The Initiative will only create greater instability. In Iraq, the inability of the US neoliberal economic reforms²³ to date to produce tangible results in the form of job creation and economic growth has resulted in large segments of the population subscribing to this interpretation.

Rejectionists/Conspiracy Theorists: This group is largely comprised of Islamists who believe that the Initiative is simply another ploy by Western imperialists designed to destroy their culture and identity.

A very casual reading of the Iraqi and regional newspapers suggests most observers fall in the second group. Still large segments of the populous subscribe to the third position. Significantly, however, the United States' two main allies in the region fall in the first group. Egyptian President Hosni Mubarak and Saudi Arabian King Fahd and Crown Prince Abdullah are on record to the effect that Arab states proceed on the path of development, modernization and reform in keeping with their people's interests and values.

ASSESSMENT

The analysis above demonstrates the basic soundness of the US BMEI initiative. Perhaps more importantly, the findings suggest that an operational strategy of addressing deficiencies in the reform structure of countries tailor-made to their different stages of development is likely to be an effective tool in reducing the conditions often conducive to the growth and spread of terrorism. Still, unless the United States finds a way to work within the set of parameters noted above by the cautious optimists, US reform initiatives in the region will have little chance of improving the living standards and providing a stable environment to large segments of the local populations. For their part the governments in BMEI countries must reorient their thinking toward the general acceptance of market solutions. In particular,

Allowing markets to prevail requires having a set of cultural values that emphasize the virtue of competition, the ability to create and gain in a socially acceptable way, the legitimacy of profits and the importance of freedom of transaction. Spreading a market culture in the region is therefore not only an exercise in economic restructuring but also an acceptance of the basic values and standards that make the system work.²⁴

NOTES

1. Robert Looney, "Iraq as a Transition Economy," *The Milken Institute Review* (Fourth Quarter 2004), pp. 14-23.
2. John Hughes, "Whispers of Democracy Across the Middle East," *Christian Science Monitor*, October 22, 2003.
3. The original GMEI was a set of US sponsored policies aimed at democratizing and developing the Middle East though the creation of liberal market economies. However it was perceived by many in the region as an attempt by the US to impose, by force if necessary, its world view on the region. The BMEI is intended to dispel this notion. It also incorporates the main concerns of the European contingent at the June 2004 G-8 meetings.
4. Anthony Cordesman, "The West is Mired in a Losing Battle," *Financial Times*, July 21, 2004.
5. Cf. Marina Ottaway, "The Broader Middle East and North Africa Initiative: A Hollow Victory for the United States," Carnegie Endowment for International Peace, June 2004.
6. See for example Marc Miles, Edwin Feulner, Mary Anastasia O'Grady and Ana Eiras, *2004 Index of Economic Freedom* (Washington: Heritage Foundation, 2004).
7. Available from: Global Economic Software, Ltd, www.globaleconomic-software.com. Cf Robert Looney, "Iraq's Economic Transition: The Neoliberal Model and its Role," *The Middle East Journal* 57:4 (Autumn 2003), pp. 568-587 for an application of this data set to the Middle East.
8. Ana Isabel Eiras, *Ethics, Corruption and Economic Freedom* (Heritage Foundation, December 9, 2003).
9. Herbert Kitschelt, "A Review of the Political Economy of Governance" World Bank Policy Research Working Paper 3315, May 2004, p. 1.
10. Daniel Kaufman, Aart Kraay and Massimo Mastruzzi, *Governance Matters III: Governance Indicators for 1996-2002* (Washington: World Bank, June 30, 2003).
11. As defined in Jeffrey Sachs, "Globalization and Patterns of Economic Development," *Weltwirtschaftliches Archiv* 136:4 (2000), p.581. Sachs considers these countries to be narrowing the income gap with higher technology and richer countries through a process of technological diffusion and capital flows from the leader to follower.
12. W.W. Rostow, *The Stages of Economic Growth* (Cambridge: Cambridge University Press, 1960).
13. Ibid, p. 284.

14. Earlier criticisms are summarized in Stephen Enke, "Economists and Development: Rediscovering Old Truths," *Journal of Economic Literature*, 7:4 (December 1969), pp. 1125-1139.

15. Jennifer Bremer and John Kasarda, "The Origins of Terror: Implications for U.S. Foreign Policy," *The Milken Institute Review* (Fourth Quarter 2002), p. 34ff.

16. Other BMEI countries in the sample, Egypt and Turkey were grouped as stage 2 countries, while the UAE was placed in stage 3 (along with Israel, a non-BMEI country).

17. A discussion of this technique together with several examples is given in: "Discriminant Analysis," in *SPSS Base 10.0 User's Guide* (Chicago: SPSS Inc 1999), pp.315-322.

18. Based on the data sets, the period of analysis was 1995-2002.

19. A full set of tables and statistical results are available from the author upon request.

20. The one exception was Mexico, which was originally classified as a phase 3 country, but was placed in phase 2 by the discriminant program.

21. High values for the governance variables are best, while low values for the economic freedom variables indicate high levels of attainment.

22. Following, Duygu Bazoglu Sezer, "The Greater Middle East Initiative, A Turkish Perspective," *Dar al Hayat*, June 13, 2004.

23. Cf. Robert Looney, "Iraq's Economic Transition: The Neoliberal Model and its Role," *The Middle East Journal* 57:4 (Autumn 2003), pp.568-587; and Robert Looney, "The Viability of Economic Shock Therapy in Iraq," *Challenge*, September/October 2004, pp. 86-103.

24. Henry T. Azzam, "Changing the Legacy of Failure in the Arab World," *Arab News*, May 17, 2004.

COMMENTARY

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Before commenting on Robert Looney's very valuable stage theory analysis of the Iraq situation, I wish to commend his understanding of the idealistic motivation of the attack on Saddam. The Bush administration wished to solve a very unstable Middle East situation by using Saddam's villainy to start democratic development in the Middle East and to promote peace between the Israelis and the Palestinians.

I had publicly opposed this venture because I thought it was too high variance to warrant support. If the venture failed, the situation would be much worse than if the attack had not occurred. And success in other than the initial military venture was problematic.

The usual attacks on the policy make little sense. Although the CIA is often wrong, this time they had excellent reasons for their beliefs including the refusal of the Iraqis to provide the documentation on destruction of WMD the UN resolution called for. The administration did not lie about WMD. Everyone was sure Saddam had them. Even a few Iraqi generals who knew their divisions did not have such weapons were sure that other divisions did have them. It is possible that even Saddam believed he had such weapons. Subordinates in such regimes always misinform their bosses. When Stalin ordered his generals to remove factories from East Germany to Russia, they reported their removal by rail but not that the factories were rusting in rail yards because there were no facilities for installing and operating them.

Moreover, if Bush had allowed the inspections to proceed—overlooking the fact that he could not keep his troops on high alert for the required interval or employ them in high summer weather—Saddam would have surely acquired such weapons. If the inspections had found no WMD, the United States would have been under enormous pressure in the Security Council from Europe and Russia for commercial reasons and because of widespread bribery to remove the sanctions. I stated this in one of my

opposition pieces but preferred the costs of this policy, including eventual use of such weapons by Saddam, to the downside of a failed Iraq venture in an unfriendly international environment.

Looney's valuable article assesses the likelihood that Middle Eastern countries will move by stages to development. Although American success in Iraq would likely dampen international terrorism, only development is likely to reduce it to miniscule proportions. Looney assesses stage theories of development from Eugene Rostow's seminal paper of the sixties to contemporary versions. His charts show how progression has taken place in a variety of nations.

Looney's presentation is specific and clear. Perhaps a specialist could find minor flaws in it. But I do not think that the reader would gain anything from my recapitulation of his analysis.

Of all the states in the Middle East, Iraq has more capabilities to succeed than any other. However, the issue is still in doubt...

The issue is whether there is a reasonable chance that democratic development can take off in the Middle East if a stable democratic government emerges in Iraq. Of all the states in the Middle East, Iraq has more capabilities to succeed than any other. However, the issue is still in doubt although it is obviously urgent

for the Bush administration to succeed if we are to reap the benefits of its policies and to avoid the massive costs of failure.

Looney sees hope in Egypt. I must admit to some pessimism. Development requires at least the rule of law and a minimum of ethics. Ethics are now in short supply even in the United States. Law firms charged several hundred thousand dollars per client to issue carbon copy opinions that a contrived tax shelter is legal. They surely knew this opinion was not likely to be shared by the IRS. But the clients knew that inspections were very unlikely and, even if they occurred, believed the opinion would shelter them from criminal charges. Furthermore, it was believed that law firms would not have to reveal a list of clients if one were uncovered.

This never was a legitimate attempt to get the most from the wording of the tax laws. It was an unethical get rich scheme for lawyers and clients even if not provably criminal beyond reasonable doubt in a court of law. The law

firms are now being sued by their clients and likely will lose in court. But, as far as I can see, no bar association has brought disbarment proceedings. If law were an ethical profession, that surely would have occurred.

I need not mention, Enron et cetera. Even apart from these criminal activities, most corporations are run for the profit of their leaders with interlocking boards that grease each other's palms. Although some entrepreneurs, for instance, Bill Gates and some bankruptcy specialists earned their rewards, most arrogantly fail to understand that they could be replaced at much lower cost.

My experiences in the Middle East suggest that American legal and corporate practices, as bad as the are, are far more ethical than Middle Eastern ones. With respect to Egypt, I had more than half a dozen close Egyptian friends as a graduate student long, long ago. They were wonderful, warm human beings. But I would not have trusted a single one to put ethics or country above individual or family self interest.

In 1948, my Egyptian friends were very much in favor of the destruction of Israel. They were all subsidized heavily, although most came from wealthy families. Their tuition was paid for and they received a \$250 monthly stipend. I was on the GI bill and grateful for my tuition and \$75 monthly stipend. When Egypt got into hard currency difficulties because of war expenditures, it reduced the stipend by about ten percent. Virtually every one of my Egyptian friends told me that this "evil government" that had reduced their stipends, to earn which they had done nothing, must be brought down.

Kuwait is a prime example of contemporary Arab culture. The Gulf War saved the Kuwaitis. Cooperation with the American recent invasion was clearly in their interests because they knew Saddam would attack them again if he ever got the chance. Moreover, it was an opportunity for revenge. Yet, apparently Kuwait, and not Halliburton, was responsible for the excessive oil charges. The American ambassador to Kuwait made it clear to the military and Halliburton that the subcontract had to go to a

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specific Kuwaiti company. The most likely reason for his intervention was that this was required to assure active Kuwaiti cooperation. This would have been only minor graft if the favored company had charged a near normal mark-up. However, to keep their active cooperation we were subjected to exploitation in the midst of a military campaign.

The astounding and courageous turnout of the Iraqis in the election may indicate that they have enough public spirit to succeed in self-government. If President Bush succeeds in pulling this gamble off, he will have insured a highly honorable place in history. Although I still stand by my previous judgment, I hold only contempt for those who challenged his motivation or the justice of the cause.